

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Cogdill Analyst: Jane Tolman Bill Number: AB 565
Related Bills: None Telephone: 845-6111 Introduced Date: 02-18-2003
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Clean-Burning Device Credit

SUMMARY

This bill would allow a tax credit for a certified clean-burning fireplace device.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to encourage taxpayers to replace an older, non-certified woodstove or fireplace with a clean-burning device that is certified by the Environmental Protection Agency (EPA).

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. It would be operative for taxable years beginning on or after January 1, 2003, and before January 1, 2008.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Currently, no federal or state tax credit exists for the purchase and installation of certified clean-burning devices.

THIS BILL

For taxable years beginning on or after January 1, 2003, and before January 1, 2008, this bill would allow a qualified taxpayer a 25% credit for the total amount paid or incurred for the purchase and installation of a certified clean-burning device.

Board Position:

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_____ N	_____ OUA	_____ X PENDING

Department Director
Gerald H. Goldberg

Date
04/01/03

A “qualified taxpayer” means an individual or corporation that owns a wood stove or fireplace that is not certified by the EPA and replaces that woodstove or fireplace with a clean-burning device that is certified by the EPA. The qualified taxpayer could replace the old fireplace or woodstove by either;

- retrofitting the old fireplace or woodstove with a clean wood burning insert, or
- rendering the old fireplace or woodstove permanently inoperable and installing a new clean-burning appliance elsewhere in the taxpayer’s home or business.

A “certified clean-burning device” is a fireplace or woodstove that is certified as being clean-burning in accordance with United States EPA standards.

This bill would allow any unused credit to be carried forward indefinitely.

This credit would be repealed by its own terms on January 1, 2009.

IMPLEMENTATION CONSIDERATIONS

This bill would raise the following implementation considerations. Department staff is available to assist the author with any necessary amendments.

This bill does not limit the number of years for the carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

Credits are typically based on a percentage of the “cost” paid or incurred for the acquisition or installation of a particular item. This credit is based on the total amount paid or incurred for a certified clean-burning device, with no clarity regarding the particular costs eligible for the credit. As a result, the credit could apply toward the interest from financing the total amount paid.

The bill does not specify whether the device must be new or whether the credit would apply to used or refurbished devices.

It is unclear if the taxpayer or business can replace the old woodstove or fireplace with more than one certified clean-burning device and as a result, receive a greater credit.

It is possible that a taxpayer could purchase the clean-burning device, claim the credit, and resell the clean-burning device to a third party that may also claim the credit. Thus allowing a double credit for the same clean-burning device.

This bill does not require the clean-burning device to be installed on the taxpayer’s property, nor does it require the clean-burning device to be installed in this state. As a result, the taxpayer could purchase a clean burning device for replacement of an old fireplace or woodstove for any individual or business, in any state. If this bill were to require that the clean-burning device be placed in service in California, with an appropriate recapture provision to ensure continued operation in California, the potential problem would be avoided. The recapture provision would require the taxpayer to use the clean-burning device for a certain length of time in this state or add all or some portion of the credit amount back to the tax liability.

This bill would apply to taxpayers replacing woodstoves and fireplaces. Generally, taxpayers are allowed to deduct ordinary and necessary business expenses or depreciate the cost (basis) of property or improvements to property used in a trade or business or for the production of income. This bill does not require the taxpayer to reduce those deductions or the basis of the clean-burning device for purposes of computing any allowable depreciation. As a result, businesses purchasing new clean-burning devices would receive a double benefit, a deduction and a credit for the same expense.

This bill defines several terms but it is silent with regard to the meaning of “fireplace” or “woodstove.” Without a clear definition for these terms disputes may arise between the taxpayer and the department concerning what qualifies for the credit.

Although this bill attempts to define the term “install,” it is unclear what the definition means.

The credit would only apply to clean burning devices certified by the EPA. As a result, taxpayers purchasing clean burning devices not certified by the EPA would be ineligible for the credit.

TECHNICAL CONSIDERATIONS

The author refers to the Environmental Protection Agency (EPA) and then refers to the United States Environmental Protection Agency. For consistency, the author may wish to consider using only one term.

OTHER STATES’ INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable tax credits or deductions. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department’s cost.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following order of magnitude revenue losses annually beginning in 2003-04.

Estimated Revenue Impact of AB 565 As Introduced 2/18/03 [\$ In Millions]		
2003-04	2004-05	2005-06
-\$20	-\$20	-\$20

The bill would be effective with income years beginning on or after January 1, 2003, with enactment assumed after June 30, 2003.

Revenue Discussion

The number and cost of clean-burning devices installed by qualified taxpayers and the amount of credits that can be applied to reduce tax liabilities would determine the revenue impact of this bill.

The estimate was derived by (1) quantifying a number of housing units that potentially could be eligible for the credit, (2) projecting that one in twenty (5%) would replace an uncertified woodstove or fireplace with a certified unit for purposes of the credit, and the number of replacements would occur ratably over the five-years the credit would be available, and (4) assuming an average cost of \$1,800 per replacement unit.

The U.S. EPA regulation required all woodstoves sold on or after July 1, 1990, to meet certain emission limits. Roughly 85% of California's 5.8 million owner-occupied housing units were constructed before 1990. If one in ten have already replaced a woodstove or a fireplace with a clean-burning device, then approximately 4.4 million units potentially could be eligible for the proposed credit [5.8 million x .85 x .90].

If 5% of the 4.4 million units actually replace a woodstove or a fireplace with a clean-burning device for purposes of the credit and replacement occurs ratably over the five-years the credit is available, then approximately 44,000 units would qualify each year for the credit. At an average cost of \$1,800 per clean-burning device, qualified costs would total \$79.2 million annually. Applying the 25% credit would derive an annual revenue loss of \$19.8 million. As the average credit would be \$450 per clean-burning device, it is assumed that all credits would be applied in the year generated.

Results of the Placer County woodstove rebate program indicated an average price of replacement certified woodstoves at about \$1,600 to \$1,800 and gas stoves at about \$2,200. Average costs for pellet stoves tend to be somewhat higher. For this analysis, an average cost of \$1,800 per clean-burning device is used.

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